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December 30, 2015

TO: Supervisor Hilda L. Solis, Chair
Supervisor Mark Ridley-Thomas
Supervisor Sheila Kuehl
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: John Naimo *John Naimo*
Auditor-Controller *for*

SUBJECT: **L.A. CARE HEALTH PLAN ADMINISTRATIVE COST ANALYSIS
REVIEW**

We have completed a review of L.A. Care Health Plan's (L.A. Care or Agency) administrative cost analysis. L.A. Care is the licensed Local Initiative Health Authority (Local Initiative) for the County of Los Angeles (County), and is an independent, tax-exempt public agency created by the County to provide managed health care services to low-income County residents. Title 28 of the California Code of Regulations Section 1300.78(b) requires that administrative costs of licensed health care service plans should not exceed 15% of each plan's total revenues.

Background

During our review of L.A. Care's financial condition issued in March 2015, we noted that the Agency's administrative expense ratio was approximately 4.5% for Fiscal Years (FY) 2011-12 through 2013-14, which was lower than the average 6.5% administrative expense ratio of the three most comparable Local Initiatives (i.e., CalViva Health Plan, Inland Empire Health Plan, and Health Plan of San Joaquin) we used to compare to the Agency. We also noted that L.A. Care primarily provides the delivery of health care services to members by contracting with its Plan Partners (i.e., Anthem Blue Cross of California, Care 1st Health Plan, and Kaiser Foundation Health Plan). The purpose of these partnerships is to provide L.A. Care members more choices and flexibility with their health care needs.

In June 2015, we conducted a follow-up review, and reported to your Board regarding L.A. Care's implementation status of the recommendations from our March 2015 report on the Agency's financial condition. In addition, we noted that L.A. Care's Plan Partners have additional administrative expenses that are not factored into L.A. Care's total administrative costs. As a result, certain adjustments may be necessary to ensure that an accurate comparison of administrative costs can be made between L.A. Care and the other Local Initiatives.

To address the concerns from our June 2015 review of the Agency's total administrative expenses, L.A. Care made relevant adjustments, and prepared an analysis of their FY 2013-14 administrative costs compared to eight Local Initiatives (i.e., Inland Empire Health Plan, CalViva Health Plan, Health Plan of San Joaquin, Alameda Alliance for Health, Kern Health Systems, San Francisco Community Health Authority, Santa Clara County Health Authority, and Contra Costa County Medical Services) and three County Organized Health Systems (i.e., Orange County Health Authority, San Mateo Health Commission, and Partnership Health Plan).

Scope and Results of Review

For this review, we examined the September 2015 administrative cost analysis that L.A. Care prepared covering FY 2013-14 (Attachment). Our review included interviewing L.A. Care financial management and staff, and evaluating the accuracy and reasonableness of the Agency's administrative cost analysis report. We determined that the methodology L.A. Care used for adjusting their total revenues and administrative expenses to exclude their Plan Partners line of business in their analysis is reasonable, and that the Agency's unadjusted and adjusted administrative expense ratios did not exceed the California Code of Regulations' maximum administrative expense to total revenues ratio of 15%, as discussed in detail below. In addition, we compared the revenue and administrative expense information L.A. Care included in their analysis to the figures the health plans reported to the California Department of Managed Health Care, and verified that the information reconciles, and is complete and accurate.

Comparison to Other Health Plans

L.A. Care's Administrative Cost Analysis

L.A. Care's analysis indicates that although the Agency is the largest health plan compared to the other 11 health plans the Agency used to compare their business, L.A. Care has one of the lowest administrative expense ratios at 4.3% for FY 2013-14 (Figure 2.0), with roughly 64.6% of the Agency's health care expenses paid by capitation (i.e., fixed per-enrollee payments to Plan Partners), and the remaining 35.4% paid by non-capitation (i.e., payments to direct in-network providers) (Figure 3.0). Figure 3.0 of the Agency's analysis also shows that nine health plans generally delegate

(i.e., contract out managed health care services) a percentage of their business to contracted parties, with CalViva Health Plan delegating nearly all of its business. L.A. Care indicated that there is variability (e.g., size of health plans, percentage of delegated business, etc.) across the health plans that would affect their administrative expenses if the expenses are adjusted to account for the delegation.

In addition, L.A. Care recalculated their administrative expense ratio to exclude the Agency's Plan Partners line of business from their overall operations (Figure 4.0). L.A. Care's total revenues would be reduced by \$1.7 billion, from \$4.1 billion to \$2.4 billion, and their administrative expenses reduced by \$29.0 million, from \$176.8 million to \$147.8 million. As a result, the Agency's administrative expense ratio would increase from 4.3% to 6.2%. L.A. Care's analysis further illustrates that with these adjustments, the Agency's administrative expense ratio would be approximately the average of all of the other health plans' unadjusted ratios of 6.1% (Figure 5.0).

Additional Administrative Cost Analyses

Since L.A. Care only adjusted their figures to exclude their delegated line of business and not the other health plans' figures, we contacted the three Local Initiatives we compared L.A. Care to in our March 2015 review to provide us their adjusted total revenues and administrative expenses to exclude their delegated lines of business. Although Inland Empire Health Plan and Health Plan of San Joaquin were unable to provide us their adjusted revenues and administrative expenses, we noted that CalViva Health Plan's ratio would remain the same at 5.9%, since they delegate nearly all of their business. L.A. Care's adjusted administrative ratio of 6.2% would only be slightly higher than CalViva's ratio.

We also worked with the Agency to determine what L.A. Care's administrative costs would be if the Agency did not contract at all with its Plan Partners (i.e., did not delegate direct care and administrative expenses). L.A. Care recalculated their revenues and administrative expenses, and estimated that their total revenues would remain the same, but their administrative expenses would increase by \$23.5 million to \$200.3 million. The increase would primarily consist of non-medical salaries and employee benefits to support the additional members. This would slightly increase their administrative expense ratio to 4.8%. We noted that even with these adjustments, the Agency's administrative expense ratio would be lower than the average of all of the other health plans' unadjusted ratios.

As previously mentioned, L.A. Care's FY 2013-14 administrative expenses attributed to Plan Partners was \$29.0 million, and included employee salaries and benefits, temporary labor and recruitment, services and supplies, marketing efforts, etc. We reviewed the high-level details of these administrative expenses provided by L.A. Care, and determined that the expenses are generally allowed under Title 28 of the California Code of Regulations Section 1300.78(a).

Current Administrative Expenses

From FY 2013-14 through September 30, 2015, L.A. Care's total revenues and administrative expenses increased from \$4.1 billion to \$6.4 billion (54%) and \$176.8 million to \$261.6 million (48%), respectively. L.A. Care's slightly higher growth in total revenues relative to administrative expenses has decreased the Agency's administrative expense ratio to 4.1%. L.A. Care indicated that the increase in total revenues was due to the increase in their Medi-Cal Expansion membership caused by the Affordable Care Act roll out, while their administrative expenses to support the new members grew at a slightly lower rate.

Review of Report

We discussed our report with L.A. Care management, and they agreed with our assessment of their analysis and the additional administrative cost analyses we conducted. We will continue to review L.A. Care's financial condition annually, and will conduct our next review in spring 2016. We will also conduct other operational and financial audits in the future, as needed. We thank L.A. Care management and staff for their cooperation and assistance during our review. If you have any questions, please contact me, or your staff may contact Robert Smythe at (213) 253-0100.

JN:AB:PH:RS:JU

Attachment

c: Sachi A. Hamai, Chief Executive Officer
Patrick Ogawa, Acting Executive Officer, Board of Supervisors
Mitchell H. Katz, M.D., Director, Los Angeles County Health Agency
John Baackes, Chief Executive Officer, L.A. Care Health Plan
Tim Reilly, Chief Financial Officer, L.A. Care Health Plan
Public Information Office
Audit Committee



September 30, 2015

John Naimo
Auditor-Controller
County of Los Angeles
500 West Temple St. Room 525
Los Angeles, California 90012

Tim Reilly
Chief Financial Officer

Dear Mr. Naimo,

This is a follow-up to our conversation on May 13, 2015. At that time, we met to discuss your financial review of L.A. Care Health Plan and to plan for future reviews. During our discussion it was agreed that L.A. Care would get back to you with an analysis of administrative costs, and how to appropriately compare L.A. Care's costs with similar health plans. We have completed our analysis and it is presented below.

As you know, in early 2015, the Board of Supervisors instructed your office to review the financial condition of L.A. Care. Your review included interviewing L.A. Care financial management, analyzing L.A. Care's audited financial statements and budget, evaluating internal policies and procedures related to their administrative and financial operations, and reviewing documentation related to their administrative expenses. You also compared L.A. Care's financial performance to comparable Local Initiative Health Authorities in the California.

You noted in your March 13, 2015 review that for fiscal year 2013-14, L.A. Care's financial performance was generally comparable to the financial performance of three Local Initiatives, Inland Empire Health Plan, CalViva Health and Health Plan of San Joaquin. You also noted that the administrative expenses of these three Local Initiatives were slightly higher, averaging 6.5% of their total operating expenses in fiscal year 2013-14, as seen in your "Table 3" in Figure 1.0 below.

Figure 1.0

TABLE 3 LOCAL INITIATIVES - FINANCIAL COMPARISON FISCAL YEAR 2013-14				
Performance Factors:	L.A. Care Health Plan	Inland Empire Health Plan	CalViva Health	Health Plan of San Joaquin
Market liquidity	FAIR	FAIR	FAIR	FAIR
Short-term liquidity	FAIR	FAIR	FAIR	FAIR
Ability to carry operating costs	GOOD	GOOD	WEAK	GOOD
Ability to generate income in excess of expenses	GOOD	GOOD	GOOD	GOOD
Profitability	FAIR	FAIR	FAIR	WEAK
Overall Performance Rating	FAIR	FAIR	FAIR	FAIR
Governing Agencies Net Equity Requirement	MET	MET	MET	MET
Administrative Expenses / Operating Expenses	4.3%	6.6%	6.2%	6.7%

In the June 3, 2015 update to L.A. Care's Board of Supervisors, your office reported that while L.A. Care's administrative expenses were lower than the average administrative expenses of the three most comparable Local Initiatives, there may be other issues that need to be accounted for in the comparison. You noted that "L.A. Care's Plan Partners have additional administrative costs that do not factor into L.A. Care's total administrative costs." Your office concluded that "As a result,

certain adjustments may be necessary to ensure that an accurate comparison of administrative costs can be made between L.A. Care and other Local Initiatives.” You asked L.A. Care to prepare an analysis that would allow for a more accurate comparison with other public plans.

Presented below is an analysis of the public health plan’s administrative costs. The Local Initiatives and County Organized Health Systems (COHS) across California vary greatly in terms of membership, revenue, expense, income and operating configurations. To provide a complete picture to account for these variations I am providing three different views of administration expense. First, I have a straight forward comparison of L.A. Care to all of other public plans. Second, I’m providing an analysis of the configuration of the health plan’s network to illustrate how much of the administrative work is delegated to a third party. Lastly, I have computed L.A. Care’s administrative costs without the Plan Partner’s (Medi-Cal) business.

1) Straight forward Public Health Plan Comparison

Figure 2.0 below, compares L.A. Care to 11 other public plans, both Local Initiatives and COHS, operating in California. The plans range in annual revenue from \$4.1 billion (L.A. Care) down to \$54 million (Ventura County). L.A. Care is the largest in terms of membership, annual revenue and total administrative expense but has one of the lowest administrative ratios as well administrative costs per member per month (PMPM).

Figure 2.0

Health Plan Comparison Fiscal Year Ending 2014												
(\$ 1,000's unless indicated)	Alameda Alliance For Health	Contra Costa County Medical Services	CalViva Health Plan	Inland Empire Health Plan	L.A. Care Health Plan	Orange County Health Authority	San Francisco Community Health Authority	San Joaquin County Health Commission	Santa Clara County Health Authority	San Mateo Health Commission	Kern Health Systems	Partnership Health Plan
Member Months	2.2M	1.5M	2.7M	8.3M	16.8M	6.3M	1.1M	2.4M	2.0M	1.4M	1.9M	4.3M
Total Revenues	\$628,340	\$427,884	\$573,160	\$1,849,082	\$4,140,333	\$2,009,533	\$324,899	\$470,389	\$422,020	\$732,258	\$428,808	\$1,615,050
Admin Expense	\$46,557	\$15,429	\$33,728	\$87,950	\$176,825	\$80,155	\$33,158	\$23,781	\$21,585	\$66,779	\$27,868	\$64,340
Admin (%)	7.4%	3.6%	5.9%	4.8%	4.3%	4.0%	10.2%	5.1%	5.1%	9.1%	6.5%	4.0%
Admin PMPM	\$21.03	\$10.41	\$12.49	\$10.61	\$10.54	\$12.69	\$30.17	\$9.78	\$10.81	\$48.01	\$14.52	\$14.81

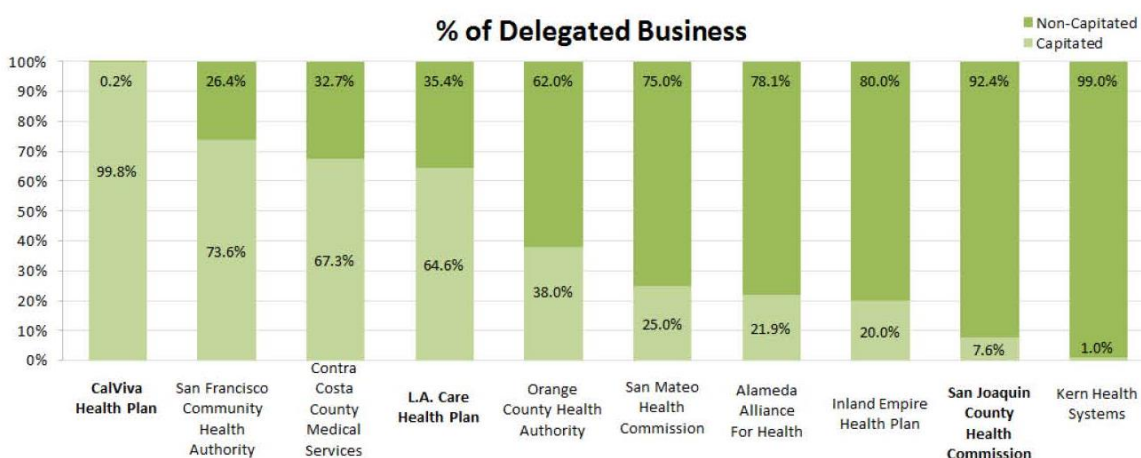
*Data source from DMHC financial reporting portal (<http://wps0.dmhc.ca.gov/fje/search>)

**Plans' fiscal year-ends differ, all data used represents annual filings for CY or FY ending 2014

2) Administrative Expenses in the Context of Provider Network Configuration (e.g. Delegation)

To assess how comparable public plan administrative costs are, presented below in Figure 3.0 is a comparison of the percentage of health care expenses that are paid by capitation along with the corresponding measure of delegated direct care and administrative expense. The top portion of the columns signifies the non-capitated share of business while the bottom half represents the capitated. As you can see below, there is a lot of variability across the health plans which would affect their administrative costs if adjusted to account for the delegation.

Figure 3.0



*Information gathered from a survey of represented plans and DMHC filings

**Plans' fiscal year-ends differ, all data used represents annual filings for CY or FY ending 2014

3) L.A. Care's Administrative Expenses with Plan Partner's Business Removed

L.A. Care insured 1.4 million Medi-Cal members during the fiscal year that ended September 30, 2014, which translates to 16.8 million member months. Of these members, 789,000 members, or 9.4 million member months, elected to receive their health care from one of our three Plan Partners (Anthem, Care 1st or Kaiser). L.A. Care pays these partners a capitated rate per member per month and incurs various administrative expenses, both of which are reported on our financial statements under health care expenses and administrative expenses, respectively. L.A. Care's recorded administrative expense associated with Plan Partner membership is low. To accurately compare L.A. Care's overall administrative costs to other plans, we have separated the Plan Partners line of business (LOB) from the rest of our operations, as seen in figure 4.0.

Figure 4.0

**Health Plan Comparison with L.A. Care Adjustment
Fiscal Year Ending 2014**

(\$ thousands unless indicated)	Contra Costa County Medical Services	Orange County Health Authority	L.A. Care Health Plan	Inland Empire Health Plan	San Joaquin County Health Commission	CalViva Health Plan	L.A. Care Excl. Plan Partners	Kern Health Systems	Alameda Alliance For Health	San Mateo Health Commission	San Francisco Community Health Authority
Member Months	1.5M	6.3M	16.8M	8.3M	2.4M	2.7M	7.3M	1.9M	2.2M	1.4M	1.1M
Total Revenues	\$427,884	\$2,009,533	\$4,140,333	\$1,849,082	\$470,389	\$573,160	\$2,401,017	\$428,808	\$628,340	\$732,258	\$324,899
Admin Expense	\$15,429	\$80,155	\$176,825	\$87,950	\$23,781	\$33,728	\$147,801	\$27,868	\$46,557	\$66,779	\$33,158
Admin (%)	3.6%	4.0%	4.3%	4.8%	5.1%	5.9%	6.2%	6.5%	7.4%	9.1%	10.2%
Admin PMPM	\$10.41	\$12.69	\$10.54	\$10.61	\$9.78	\$12.49	\$20.24	\$14.52	\$21.03	\$48.01	\$30.17

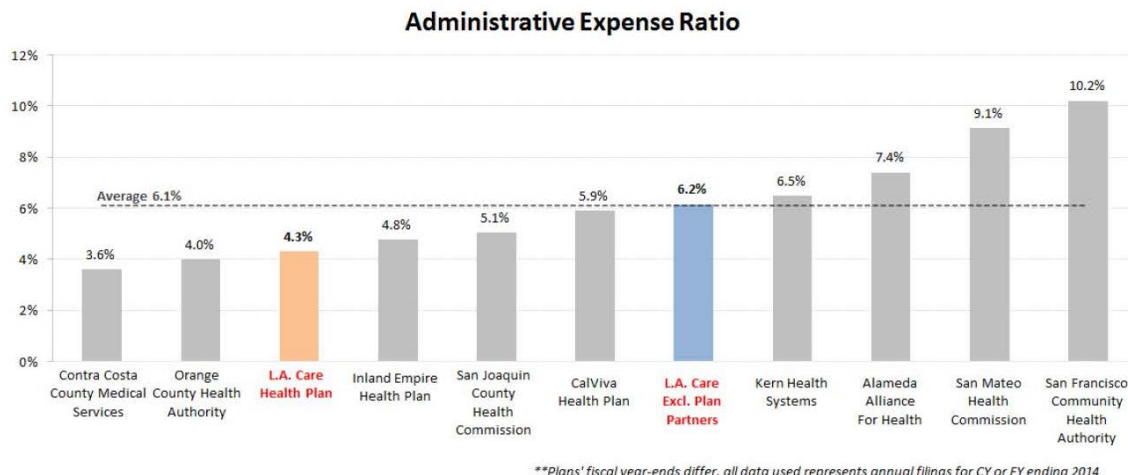
*Data source from DMHC financial reporting portal (<http://wpsa.dmh.ca.gov/fe/search>)

**Plans' fiscal year-ends differ, all data used represents annual filings for CY or FY ending 2014

Excluding the Plan Partners Medi-Cal LOB in our comparison, L.A. Care drops to the second largest plan in terms of membership, but remains the largest in revenue in California. It is important to note that this is comparing L.A. Care with an adjustment to account for delegation to all other plans unadjusted. If you refer to figure 3.0 above, there are multiple plans with a reasonable amount of delegated business. If those plans were also adjusted to exclude their delegation, other plans

would yield an increased administrative ratio and increased PMPM. However, to be conservative with our analysis we will continue comparing an adjusted L.A. Care to the unadjusted plans. After the removal of Plan Partners, L.A. Care's PMPM increased from \$10.54 to \$20.24, which is slightly above the unadjusted average PMPM's shown in the comparison.

Figure 5.0



The administrative expense ratio, total administrative costs divided by total revenue, in Figure 5.0 illustrates each plan's ratio as it relates to the average of all the plans included in the analysis. The orange and blue columns represent the slight increase of L.A. Care's ratio when removing the Plan Partners LOB. Even with the removal of \$1.9 billion in revenue associated with Plan Partners Medi-Cal LOB, L.A. Care's ratio remains on par with the 6.1% average.

Summary

Title 28 of the California Code of Regulations Section 1300.78(b) indicates that administrative costs of licensed health care service plans, like L.A. Care Health Plan, should not exceed 15%. As noted in the Auditor/Controller's report, L.A. Care has experienced significant growth in the last three fiscal years and has consistently kept their administrative expenses at approximately 4.5% of their total operating expenses. L.A. Care Health Plan is expecting to close its accounting for fiscal year 2014-15 with an administrative cost ratio less than 4%.

We periodically conduct informal comparisons of L.A. Care's financial performance to other State health plans' financial performance, and also look for administrative efficiencies. Even though many of the public plans have delegated networks, we believe that the most accurate comparison of L.A. Care costs would exclude the Plan Partners.

Please let me know if this analysis helps you set the proper context for reviewing LA Care's administrative costs. I would be happy to meet at your convenience if there are additional questions surrounding any of the calculations presented in this report.

Thank you

Tim Reilly